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Telesector Resources Group

A subsidiary of New England Telephone  
and New York Telephone

November 13, 1992

Donna R. Searcy  
Secretary  
Federal Communications Commission  
1919 M Street, N.W.  
Room 222  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Re: ONA Tariffs of Bell Operating  
Companies (CC Docket No. 92-91)

Dear Ms. Searcy:

Attached hereto is the original and 5 copies of the  
Reply of the NYNEX Telephone Companies to Comments on their  
Direct Case, with Appendix A thereto.

Please note that Appendix A contains information and  
material that is protected from disclosure on the public record  
pursuant to Commission order and existing protective  
agreements. The NYNEX Telephone Companies therefore requests  
that Appendix A be withheld from public inspection. As  
reflected on the attached certificate of service, Appendix A  
has been served only upon those parties to this proceeding who  
have entered into appropriate protective agreement.

Very truly yours,

Deborah Haraldson

DH/ef  
Attachments

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BEFORE THE  
FEDERAL COMMUNICATIONS COMMISSION  
WASHINGTON, D. C. 20554

In the Matter of

Open Network Architecture  
Tariffs of Bell Operating  
Companies

)  
) CC Docket No. 92-91  
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REPLY OF THE NYNEX TELEPHONE COMPANIES  
TO COMMENTS ON THEIR DIRECT CASE

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

The NYNEX Telephone Companies, New England Telephone and Telegraph Company and New York Telephone Company ("NET" and "NYT", respectively; the "NTCs", collectively), submit this Reply to comments on and oppositions to their Direct Case filed on May 18, 1992 in this proceeding.

This Reply addresses only the new issues raised in the comments and oppositions. The NTCs filed a thorough and complete Description and Justification in support of their Open Network Architecture ("ONA") Tariff filed on November 1, 1991. The Opposition of the NYNEX Telephone Companies to Petitions to Reject or Suspend, filed on December 9, 1991, responded to objections to the ONA Tariff raised by intervenors. In addition, the NTCs' Direct Case contained detailed information in response to questions posed by the Federal Communications Commission (the "Commission") in its Order Designating Issues for Investigation released on April 16, 1992.

Issues that have been addressed on the public record in this and related proceedings are considered in the body of this Reply, which has been served upon the Commission and all parties. Issues involving material that is protected from disclosure on the public record are considered in an Appendix hereto, which has been served upon the Commission and those parties who have entered into protective agreements.

1. Pricing Flexibility and Costing Methodology

In their Direct Case, the NTCs made two points concerning pricing flexibility. The first point is that "[e]fficient pricing . . . is predicated on the ability to respond flexibly to the context in which a service is offered".<sup>1</sup> The NTCs went on to explain that the "flexibility" they referred to is the ability "to consider in context such factors as technology mix, market conditions, and forecast demand, and the appropriate weight to be given to each such relevant factor."<sup>2</sup> The NTCs' second point is that, as the outgrowth of ONA, the ONA Tariff filing proceeding is unique and therefore an inappropriate proceeding in which to develop costing and pricing principles of general application.<sup>3</sup>

Contrary to MCI's contentions, the NTCs have never suggested that there should be "no constraint at all" on the

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<sup>1</sup> NTCs' Direct Case, Appendix A, p. 5.

<sup>2</sup> NTCs' Direct Case, Appendix A, p. 5.

<sup>3</sup> NTCs' Direct Case, p. 4.

process by which the NTCs develop rates.<sup>4</sup> In fact, the development of ONA Tariff rates has been significantly constrained by the requirement that the rate structure established by the NTCs for the newly-unbundled Basic Service Elements ("BSEs") reflect the nature of the underlying costs. Moreover, the process of developing the ONA Tariff rates has been subjected to intense scrutiny by the general public based on the extensive materials filed on the public record; by intervenors pursuant to protective agreements; by Arthur Andersen & Co. ("Arthur Andersen") in its independent review pursuant to Commission order; and by the Commission itself through its own review of the public record, the unredacted Switching Cost Information System ("SCIS") cost model software, and the unredacted report of Arthur Andersen.

For purposes of the ONA Tariff, the NTCs used a current average switching investment costing methodology. Nevertheless, as they have already stated, the NTCs have no objection to developing ONA Tariff rates based on an incremental investment approach.<sup>5</sup> What the NTCs do object to, however, is the adoption in this proceeding of a requirement that a specific costing methodology be used to develop rates in other, future proceedings.

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<sup>4</sup> Opposition to Direct Cases, filed by MCI Telecommunications Corporation, dated October 16, 1992 ("MCI Opposition"), p. 21.

<sup>5</sup> NYNEX Telephone Companies Revisions to Tariff F.C.C. No. 1, Transmittal No. 57, Opposition of the NYNEX Telephone Companies to Petitions to Reject or Suspend, filed December 9, 1991, p. 9.

Some commenters in this proceeding seem to propose long-run incremental costs ("LRIC") as the standard to be applied to all tariff rates.<sup>6</sup> The Commission should reject any proposal to set rates at LRIC or to prescribe LRIC as the only costing theory to be used to develop rates. Such a proposal is in direct contradiction of the Commission's decision to adopt a flexible, cost-based standard for the pricing of new services, and its adoption would prevent the Commission from achieving its policy objectives.

LRIC is only one cost-based method of setting rates. LRIC would be useful as a method of setting a price "floor" for certain services.<sup>7</sup> However, rates above LRIC must apply to some services in order to permit a local exchange carrier to recover its total cost of service, as LRIC does not always recover embedded costs. Moreover, a hard-and-fast requirement to set rates according to a particular cost standard or to develop all rates using a prescribed costing methodology would effectively prevent the Commission from achieving its own policy objectives, which may vary depending upon the service, the proceeding, or the economic, market and regulatory context.

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<sup>6</sup> See, e.g., MCI Opposition, p. 27.

<sup>7</sup> Rates below LRIC may be appropriate in certain circumstances, such as when demand for an existing service is declining or when the market will not support higher prices for competitive reasons. Cf. Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, released October 4, 1990, ¶ 311, where the Commission adopted average variable cost as a lower limit for below band filings, relying on antitrust precedent for lower limits on pricing.

2. NTC Tariff Rates for Three Way Calling

As the NTCs stated in their Direct Case, Three Way Calling rates were set at levels of existing intrastate Three Way Calling Business rates in order to avoid adverse effects of arbitrage and to satisfy requirements of the Net Revenue Test.<sup>8</sup>

The opportunity for arbitrage exists if the same service offered in the intrastate jurisdiction is offered in the interstate jurisdiction at a lower price. In theory, interstate BSEs may not be used in the provision of intrastate services. However, the Public Service Commission of the District of Columbia ("DCPSC") has repeatedly raised the concern that there is "a self-interest in reporting a larger volume of traffic for whichever jurisdiction has lower rates, and, to the extent that services cannot be measured, the tariffing of identical features in both the interstate and intrastate jurisdictions will result in tariff shopping."<sup>9</sup> This issue is still pending before the Commission.<sup>10</sup>

The Net Revenue Test was intended to ensure that a company's net revenues are greater if a particular service is

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<sup>8</sup> NTCs' Direct Case, Appendix A, p. 6.

<sup>9</sup> E.g., Bell Atlantic Telephone Companies/ONA Access Charge Tariff Filings, Transmittal No. 471, Petition to Reject, filed by the Public Service Commission of the District of Columbia, dated November 26, 1991, p. 4.

<sup>10</sup> See Open Network Architecture Tariffs, Memorandum Opinion and Order, DA 92-128, released January 31, 1992, ¶ 73; Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket No. 89-79, Comments of the Public Service Commission of the District of Columbia, dated September 30, 1992, p. 2-4.

offered than if it is not. The test includes a consideration of the cross-elastic effects of the service offered and, therefore, addresses the total revenue effect on the company. As of November 18, 1992, the Net Revenue Test will no longer be required. However, the same type of net revenue analysis may be used to justify rates that exceed costs in order to prevent migration from existing services that will result in a loss of revenue that exceeds the revenues to be gained from the new service.<sup>11</sup> If the NTCs' interstate rates for Three Way Calling were set at total unit costs, the net revenue analysis shows that an overall net revenue loss would occur. The NTCs have set interstate rates for Three Way Calling at state rate levels in order to prevent such a loss.

Clearly, the Commission has jurisdiction over interstate rates. The NTCs are not requesting that the Commission relinquish this authority to the states. Rather, they ask that the Commission consider its actions in light of the net revenue analysis that the Commission has authorized, and the impact upon state regulatory policies and the ability of state regulators to maintain reasonable rates.

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<sup>11</sup> Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture and Policy and Rules Concerning Rates for Dominant Carriers, CC Docket Nos. 89-79 and 87-313, Memorandum Opinion & Order On Second Further Reconsideration, released August 6, 1992, ¶¶ 11, 12, 23, 24.

3. The NTCs' Use of LESS and LAESS Switch Costs and the NTCs' Selection of Model Offices

Many of the comments and oppositions filed in this proceeding state or imply that the respective Bell Operating Companies ("BOCs") first determined what rates to propose, and only then created the data to support them. However, the comments on the NTCs' use of LESS and LAESS switch costs exemplify the willingness of some commenters to ignore the facts in order to obtain the rates that they desire.<sup>12</sup>

As the NTCs explained in their Direct Case, they included the LAESS and LESS technologies in developing BSE rates because BSEs will be provisioned using these technologies.<sup>13</sup> Furthermore, although the NTCs do not intend to put any new analog switches into service in the network, the NTCs will increase the capacity of existing LAESS and LESS switches over the short term to meet increases in demand until these analog switches are replaced by digital technology. Thus, even in a forward-looking incremental study, it could be appropriate to include costs associated with these analog switches.

Likewise, certain commenters fault the BOCs' purported failure to justify their selection of model offices. Once again, the NTCs simply relied on the facts to develop their rates. As

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<sup>12</sup> In its comments, the General Services Administration guilelessly asserts that many of the BSE rates are unreasonable, while conceding the reasonableness of the methods and variables used to develop those rates. The General Services Administration's Comments on Direct Cases, dated October 16, 1992, pp. 6-7.

<sup>13</sup> NTCs' Direct Case, Appendix A, p. 4.



the NTCs explained in their Direct Case, the offices chosen for study were representative of all states and all switch sizes for each switch technology utilized to provision BSEs. Data for offices or technologies that would not be used to provision BSEs were excluded.<sup>14</sup>

4. SCIS Redactions, Use of the SCIS Model, and Certain SCIS Inputs

Various commenters have raised additional issues concerning the NTCs' ONA Tariff, including redactions to SCIS, certain aspects of the NTCs' use of SCIS, and certain of the NTCs' underlying assumptions and inputs into SCIS. Because discussion of these issues requires disclosure of protected material and information, these issues are considered in the Appendix hereto that has been served only upon the Commission and those commenters who have entered into protective agreements.

Respectfully submitted,

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Their Attorneys

Dated: November 13, 1992

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<sup>14</sup> NTCs' Direct Case, Appendix A, p. 1.

CERTIFICATE OF SERVICE

I certify that copies of the foregoing REPLY OF THE NYNEX TELEPHONE COMPANIES TO COMMENTS ON THEIR DIRECT CASE WITH APPENDIX A THERETO were served on each of the following parties, this 13th day of November, 1992, by first class United States mail, postage prepaid:

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